



January 31, 2014

Via Electronic Mail

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Board of Governors of the Federal Reserve
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Docket No. R-1466
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Legislative and Regulatory Activities
Division
Office of the Comptroller of the Currency
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Washington, DC 20219
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Docket ID OCC-2013-0016
RIN 1557 AD 74

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
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RIN 3064-AE04

Re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring—
Notice of Proposed Rulemaking (“Proposal”)¹

Ladies and Gentlemen:

The PNC Financial Services Group, Inc. (“PNC”) appreciates the opportunity to provide comments on the Proposal, which was issued by the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Federal Deposit Insurance Corporation (“FDIC”), and the Office of the Comptroller of the Currency (“OCC”) (together the “Agencies”). The Proposal would implement the liquidity coverage ratio framework (the “LCR Framework”) established by the Basel Committee on Bank Supervision (“BCBS”) in the United States.² Under the proposal, the Agencies would establish a liquidity coverage ratio (the “Full LCR”) for banking organizations with \$250 billion or more in total consolidated assets or \$10 billion or more in on-balance sheet

¹ Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring, 78 Fed. Reg. 71,818 (Nov. 29, 2013).

² Basel Committee on Banking Supervision, Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools (revised January 2013), available at <http://www.bis.org/publ/bcbs238.pdf>.

foreign exposure as well as the subsidiary depository institutions with total assets of \$10 billion or more of these organizations (collectively “Full LCR Banks”). The Federal Reserve also has proposed to establish a modified LCR (the “Modified LCR”) as an enhanced prudential standard under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).³ This Modified LCR would generally apply to bank holding companies and savings and loan holding companies that have at least \$50 billion in total consolidated assets but that are not covered by the Full LCR (“Modified LCR Banks”).⁴

I. Introduction and Executive Summary

PNC is a regional banking organization headquartered in Pittsburgh, Pennsylvania. PNC provides a range of traditional retail banking, corporate and institutional banking, asset management and residential mortgage banking products and services primarily through PNC Bank, National Association (“PNC Bank”), PNC’s only insured depository institution subsidiary. As of September 30, 2013, PNC had total consolidated assets of \$308.9 billion. PNC Bank had total consolidated assets of \$298.5 billion as of the same date, representing 97% of the total consolidated assets of PNC.

As a result of PNC’s bank-centric organizational structure, focus on traditional deposit-taking, lending and asset management activities, and limited nonbanking and foreign activities, PNC’s balance sheet and liquidity risk profile are significantly less complex than that of larger and more complex organizations, such as the U.S. based organizations that have been identified as Global Systemically Important Banks (“G-SIBs”) by the Financial Stability Board.⁵ We believe it is important for the Agencies to understand and take into account the differences in business model, complexity and risks between regional banks like PNC and larger, more complex and internationally active banks as the Agencies move forward with implementation of the Basel LCR Framework, as well as other regulatory initiatives.

PNC has long supported the fundamental objectives of the LCR Framework, which are to promote the resilience of banking organizations, improve the banking sector’s ability to absorb shocks arising from financial and economic stress, and improve the ability of banking organizations and supervisors to measure and manage liquidity risks. PNC believes that capital strength must be supported by liquidity strength. In this regard, we recognize that during the financial crisis many troubled organizations exhausted their available liquidity well before their capital fell below regulatory minimums. Accordingly, we manage liquidity risk through a variety of means, including spot and forward-looking funding gap analyses, the monitoring of early warning indicators that may indicate a potential market or PNC-specific liquidity stress event, and robust liquidity stress tests. In the most severe of these liquidity stress test simulations, we assume that PNC’s liquidity position is under pressure, while the market in general is under systemic pressure. Moreover, PNC’s liquidity guidelines are designed to help ensure that

³ 12 U.S.C. § 5365.

⁴ Neither the Full LCR nor the Modified LCR would apply to bank holding companies or savings and loan holding companies that are insurance companies or that have significant insurance or commercial operations.

⁵ Financial Stability Board, 2013 Update of Group of Global Systemically Important Banks (G-SIBs) (Nov. 11, 2013), available at http://www.financialstabilityboard.org/publications/r_131111.pdf.

sufficient liquidity is available to meet parent company obligations over a forward looking two-year period.

We believe several important changes to the Proposal are necessary to properly align its requirements with the actual liquidity risk profile of PNC and to avoid creating an unlevel competitive playing field among similarly situated banking organizations. In addition, we believe changes are necessary to more closely reflect the actual liquidity characteristics and behaviors of customers and counterparties, even during the recent financial crisis, better incorporate the unique aspects of the U.S. financial system into the rules, and avoid other unintended consequences. The Proposal as currently structured could require banks to maintain liquidity (such as in the form of balances at the Federal Reserve) that is well in excess of what would actually be prudent to ensure that institutions can continue to operate effectively even in highly stressed environments. We are concerned that an improperly calibrated LCR could reduce the ability of banks to provide credit to businesses, governments, and consumers and counteract the efforts of policymakers to promote a more robust economic recovery. For example, in recent years, balances of U.S. banks held with the Federal Reserve have increased dramatically. While a number of factors likely have contributed to this increase, we believe a significant factor has been the anticipated implementation of the LCR in the United States. Notably between January 2013 (when the BCBS released the final LCR Framework) and January 2014, reserve balances increased from approximately \$1.57 trillion to approximately \$2.47 trillion.⁶

As discussed in detail below, we believe that the Proposal should be modified to, among other things:

- Expand the scope of the Modified LCR, which the Proposal recognizes is more appropriate for organizations that are less complex in structure, less reliant on riskier forms of market funding, and have simpler balance sheets, so that it covers PNC and other regional banks that clearly meet these criteria;
- Permit PNC and other regional banking organizations that have less complex and more stable funding profiles to calculate their liquidity coverage ratio on a monthly (rather than a daily) basis, consistent with the reporting frequency already proposed by the Federal Reserve for its liquidity monitoring report (FR 2052b);
- Allow regional banks to use a calendar-month stress period (rather than the proposed 21-day period) under the Modified LCR, which is more consistent with the nature of liquidity inflows and outflows and the more stable nature of such flows for regional banks;
- Exempt collateralized deposits placed by state and local governments from the requirement to “unwind” these transactions in calculating the adjusted cap on high-quality liquid assets (“HQLA”), and revise the outflow assumptions applicable to these deposits, to avoid unnecessary and adverse consequences for state and municipal

⁶ See Federal Reserve, [H.4.1 Statistical Release: Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks](http://www.federalreserve.gov/releases/h41/), available at <http://www.federalreserve.gov/releases/h41/>.

governments and properly reflect the observed behavior of state and municipal depositors during times of economic stress;

- Modify the criteria necessary for a deposit to be recognized as an “operational deposit” to properly reflect the nature and characteristics of deposits maintained in connection with cash management, clearing, and custody services; and
- Revise the rules so that credit and liquidity lines to operating companies, or to bank customer securitization facilities that functionally serve as (or support) a traditional revolving credit line to a business customer, are not inappropriately subject to the high outflow rates intended for structured investment vehicles (“SIVs”).

PNC participated in the development of the comment letter submitted collectively by PNC and other regional banks (the “Regional Bank Comment Letter”)⁷ as well as the joint comment letter submitted by The Clearing House Association L.L.C. (“TCH”), the American Bankers Association, the Securities Industry & Financial Markets Association, the Financial Services Roundtable, the Institute of International Bankers, the International Association of Credit Portfolio Managers and the Structured Finance Industry Group (the “Joint Trade Association Comment Letter”).⁸ We support the comments and concerns reflected in the Regional Bank Comment Letter and the Joint Trade Association Comment Letter, and the comments and recommendations in this letter are intended to supplement the comments contained in those letters.

II. Recommendations

A. PNC is More Appropriately Covered by the Modified LCR

As noted above, the Proposal includes two versions of the LCR: the Full LCR and the Modified LCR. The Proposal indicates that the Full LCR is intended to apply to internationally active banking organizations that, should they fail as a result of liquidity stress, would have significant systemic impact.⁹ On the other hand, the Proposal specifically recognizes that the Modified LCR is appropriate for organizations that—

- Are less complex in structure, less reliant on riskier forms of market funding, and have simpler balance sheets;
- Have liquidity risks that are easier for management and supervisors to monitor and address quickly in a stressed scenario; and
- Would likely not have as great a systemic impact as larger, more complex companies should they experience liquidity stress.¹⁰

⁷ See Letter to the Agencies from PNC, BBVA Compass Bancshares, Inc., Capital One Financial Corporation, Comerica Bank, Fifth Third Bancorp, Huntington National Bank, KeyCorp, M&T Bank Corporation, RBS Citizens Financial Group, Regions Financial Corp., SunTrust Banks, Inc., TD Bank US Holding Company, Union Bank, N.A., and U.S. Bancorp (Jan. 31, 2014).

⁸ See Letter to the Agencies from the Joint Trade Associations (Jan. 31, 2014).

⁹ See Proposal, at 71,846.

¹⁰ Id.

We believe that PNC clearly meets each of these criteria and, for this reason, should be covered by the Modified LCR rather than the Full LCR. Below, we provide data that compare several key metrics related to balance sheet composition, funding profile and international activity for PNC versus the average of the same metrics for:

- The G-SIBs, each of which would be subject to the Full LCR under the Proposal;
- Selected large, regional peer bank holding companies that would be subject to the Modified LCR under the Proposal (the “Modified LCR Peer Group”);¹¹ and
- All banking organizations that we estimate would be subject to the Modified LCR under the Proposal.

As these data indicate, the balance sheet, funding profile and international activities of PNC are very different from the balance sheet, funding profile and international activities of the G-SIBs (on average). On the other hand, this same data demonstrates that the balance sheet, funding profile and international activities of PNC are very similar to that of several other large regional banks (on average) that would be subject to the Modified LCR under the Proposal, as well as the average for all banking organizations that we estimate would be subject to the Modified LCR under the Proposal.

Organizational Structure, Business Model and Balance Sheet

PNC’s organizational structure is relatively simple in comparison to larger, more complex organizations (such as the G-SIBs). For example, as noted above, an overwhelming percentage of PNC’s activities are conducted through PNC Bank. In addition, net loans and leases represent 61% of PNC’s total assets (reflecting our focus on traditional lending activities), which is close to the 63% figure for all Modified LCR Banks, and well above the 25% average for the G-SIBs. See Table 1, Column A. Similarly, the ratios of PNC’s trading assets to total assets and trading liabilities to total liabilities (less than 1% each) is well below the average for the G-SIBs (16% and 7%, respectively), and is nearly the same as the average for the Modified LCR Peer Group as well as all Modified LCR Banks. See Table 1, Columns B and C. In addition, PNC’s ratio of derivative contracts (notional value) to total assets (122%) is far below the average of the same ratio for the G-SIBs (2,549%), and more in line with the average ratio for PNC’s Modified LCR Peer Group (72%) and all Modified LCR Banks (38%). See Table 1, Column E. PNC’s derivative contracts, moreover, consist primarily of traditional interest rate and foreign currency contracts entered into to assist our banking customers or PNC hedge those risks.

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¹¹ These institutions are BB&T Corp., Fifth Third Bancorp, KeyCorp, Regions Financial Corp., and SunTrust Banks, Inc. Each of these organizations, like PNC, has been a participant in the Federal Reserve’s annual Comprehensive Capital Analysis and Review (“CCAR”) process since its inception.

Table 1--Balance Sheet Composition¹²

	A	B	C	D	E
<u>Banking Organizations</u>	Net Loans & Leases / Total Assets (%)	Total Trading Assets / Total Assets (%)	Total Trading Liabilities / Total Liabilities (%)	4(k) Broker-Dealer Assets / Total Assets (%) ¹³	Derivative Contracts (Notional) / Total Assets (%)
U.S. G-SIB – Average	25%	16%	7%	19%	2,549%
PNC	61%	<1%	<1%	<1%	122%
Modified LCR Peer Group – Average	66%	1%	<1%	<1%	72%
All Modified LCR Banks – Average	63%	<1%	<1%	2%	38%

Importantly, the fact that PNC’s operations are almost exclusively conducted out of PNC Bank and the limited nature of PNC’s full-service broker-dealer activities (see Table 1, Column D) greatly reduce the likelihood that PNC would face liquidity pressures that could not be met through traditional sources of liquidity. In this regard, should PNC face liquidity pressure, the vast majority of our operations could obtain funding by accessing ordinary course sources of liquidity available to depository institutions—such as advances under section 10B of the Federal Reserve Act¹⁴ from the Federal Reserve’s discount window and advances from a Federal Home Loan Bank (“FHLB”). These operations would not need to rely on extraordinary measures, such as those taken under section 13(3) of the Federal Reserve Act,¹⁵ to provide liquidity to nonbank entities during the financial crisis.

We believe PNC also would not present systemic risk in the unlikely event it should experience extreme liquidity pressure that causes the organization to fail. The Federal Reserve’s and OCC’s approvals issued in connection with PNC’s acquisition of RBC Bank (USA) support that conclusion.¹⁶ Moreover, the joint Federal Reserve and FDIC resolution plan rules implicitly

¹² The source of all information is SNL – FR Y-9C (data as of September 30, 2013, for the top-tier holding company). Data reported as ‘N/A’ was treated as a zero for purposes of these calculations.

¹³ Broker-dealer asset data are included only for broker-dealer subsidiaries of financial holding companies that engage in underwriting or dealing pursuant to section 4(k)(4)(E) of the Bank Holding Company Act (12 U.S.C. § 1843(k)(4)(E)), see line item 20.a. of Schedule HC-M to the FR Y-9C.

¹⁴ 12 U.S.C. § 347b(a).

¹⁵ 12 U.S.C. § 343.

¹⁶ See The PNC Financial Services Group, Inc., 98 Federal Reserve Bulletin 3, 16 (2012) (concluding that PNC’s acquisition of RBC Bank (USA) would not materially increase risks to the stability of the U.S. financial or banking system); see also OCC Corporate Decision No. 2012-05 (April 2012) (finding that the merger of RBC Bank (USA) with and into PNC Bank would not pose a risk to the U.S. banking or financial system).

recognize that PNC and regional banks like it are less likely to pose systemic risk upon failure than larger and more complex organizations.¹⁷

Funding Profile

PNC primarily relies on core sources of funding, i.e., deposits, and does not rely to a significant degree on potentially volatile short-term, wholesale sources of market funding. PNC's reliance on wholesale funding ratio is only 16%, significantly below the 46% average for the G-SIBs, identical to the average among PNC's Modified LCR Peer Group, and even slightly below the average for all Modified LCR Banks. See Table 2, Column A. Similarly, the ratio of PNC's core deposits to total assets (67%) is more than double the average for the G-SIBs (29%), and generally in line with the average for the Modified LCR Peer Group as well as all Modified LCR Banks. See Table 2, Column B. In addition, PNC engages only to a limited extent in repurchase, reverse repurchase, or other securities financing transactions. PNC's ratio of reverse repurchase agreements to total assets is less than 1%, significantly lower than the average for the G-SIBs (15%), in line with the figure for the Modified LCR Peer Group and lower than the figure for all Modified LCR Banks (3%). See Table 2, Column D. Moreover, a significant portion of PNC's small secured financing activity relates to a repo-sweep product utilized by customers of our Corporate & Institutional Banking business line, and is not used to support the funding of our limited trading activities or our broker-dealer subsidiaries. As a result of having a simpler and more stable funding profile, PNC's liquidity inflows and outflows are more stable and predictable than those of larger and more complex organizations. Thus, our liquidity risks are easier for PNC's management and our supervisors to monitor.

Table 2--Funding Profile¹²						
	A	B	C	D	E	F
<u>Banking Organizations</u>	Reliance on Wholesale Funding (%) ¹⁸	Core Deposits / Total Assets (%)	Loans / Deposits (%)	Reverse Repurchase Agreements (%)	Sec. Sold/Repo / Total Liabilities (%)	Net Short-term Liabilities/ Assets (%) ¹⁸
U.S. G-SIB – Average	46%	29%	61%	15%	11%	-21%
PNC	16%	67%	90%	<1%	1%	-4%
Modified LCR Peer Group – Average	16%	71%	91%	d E.1%	1%	-3%
All Modified LCR Banks – Average	24%	62%	96%	3%	1%	-8%

¹⁷ See, e.g., 12 C.F.R. §§ 243.3(a)(1)(iii) and 381.3(a)(1)(iii). PNC has less than \$100 billion in total nonbank assets and was part of the third and last round of resolution plan filers.

¹⁸ These ratios are used by the OCC as part of its Canary supervisory system and derived using publicly available FR Y-9C/Call Report data.

International Activity

Table 3--International Activity ¹²		
	A	B
<u>Banking Organizations</u>	Total Foreign Deposits / Total Deposits (%) ¹⁹	Avg. Foreign Loans / Avg. Total Loans (%)
U.S. G-SIB – Average	28%	18%
PNC	<1%	<1%
Modified LCR Peer Group – Average	<1%	<1%
All Modified LCR Banks – Average	1%	<1%

PNC’s limited foreign operations (see Table 3) further limit the complexity of our organizational structure and funding profile. For example, our operations do not create the potential for material cross-jurisdictional liquidity mismatches or significant liquidity being trapped in foreign jurisdictions.

We believe that these data clearly demonstrate that it would be more appropriate—both from a regulatory and a competitive equality standpoint—to expand the scope of the Modified LCR to include PNC. To effect this change, we recommend that the scope of the Modified LCR be expanded to include all banking organizations that are not G-SIBs.

The Agencies already have recognized the differences between G-SIBs and regional banks like PNC in both the liquidity and other regulatory contexts. For example, we understand that only G-SIBs currently are subject to the Federal Reserve’s daily fourth generation (“4G”) liquidity reporting requirement, and only G-SIBs would be subject to the Federal Reserve’s proposed FR 2052a daily complex institution liquidity report.²⁰ In addition, the Agencies have proposed to apply the enhanced supplementary leverage ratio only to G-SIBs through the use of the \$700 billion total consolidated asset or \$10 trillion in assets under custody thresholds.²¹

¹⁹ This figure is based on data reported by firms on a consolidated basis on the FR Y-9C. We note that this more accurately represents foreign deposits related to customer activity, as any intercompany foreign deposit activity is eliminated in consolidation.

²⁰ Proposed Agency Information Collection Activities; Comment Request, 78 Fed. Reg. 57,634 (Sep. 19, 2013). In addition to the differences in reporting frequency between the FR 2052a (daily for G-SIBs) and the FR 2052b (monthly for bank holding companies with \$50 billion or more in total consolidated assets that are not G-SIBs), the FR 2052b report also would require more limited and streamlined reporting than the FR 2052a.

²¹ Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions, 78 Fed. Reg. 51,101 (Aug. 20, 2013). Notably, the alternative scope for the Full LCR we propose, according to the OCC’s analysis under the Unfunded Mandates Reform Act, also would be the least costly alternative. See infra note 29.

We believe the same factors that warranted a distinction between G-SIBs and regional banks like PNC in those matters also warrant distinguishing between G-SIBs and regional banks like PNC in applying the LCR. Doing so would be consistent with the direction provided by Congress in Section 165 of the Dodd-Frank Act, which provides for any enhanced prudential standards to be tailored based on a firm's riskiness, complexity, size and financial activities, as well as other relevant risk-related factors.²² We note, moreover, that PNC and other regional banks that fall below the revised threshold for the Full LCR would continue to be subject to robust liquidity requirements that are more appropriate for our organizations. These would include the:

- Same quantitative liquidity risk management requirements that apply to other regional banking organizations;
- Federal Reserve's proposed enhanced liquidity standards established under section 165 of the Dodd-Frank Act;²³ and
- Agencies' liquidity risk management expectations set forth in the Interagency Policy Statement on Funding and Liquidity Risk Management.²⁴

Importantly, the Agencies also have the flexibility under the Basel LCR Framework to expand the scope of the Modified LCR in the manner we recommend. The Basel frameworks, including the Basel LCR Framework, provide national authorities responsibility for identifying those organizations that should be considered "internationally active" for purposes of implementation of the relevant frameworks.²⁵ While the Agencies have defined this phrase for purposes of the risk-based capital rules as any banking organization with \$250 billion or more in total consolidated assets or \$10 billion or more in on-balance sheet foreign exposure, we do not believe the Agencies should, or are required to, use these thresholds as the attachment point for the Full LCR. As the data in Tables 1-3 illustrates, PNC has only limited foreign operations and has a liquidity profile that is very different from large, internationally active banks like the G-SIBs. We believe it is particularly appropriate for the Agencies to exercise the flexibility they have under the LCR Framework to establish a different threshold for LCR purposes in light of the fundamentally different frameworks being implemented by the LCR (a quantitative liquidity framework) and the advanced approaches (a risk-based capital framework).

If, nonetheless, the Agencies are unwilling to raise the threshold for application of the Full LCR in the manner proposed above, we believe the Agencies should, at a minimum, modify the Full LCR to better reflect the lower liquidity risk posed by banking organizations that are predominately composed of insured depository institutions, which, by law, have access to the Federal Reserve's traditional discount window to help address short-term liquidity pressures. One option for doing so would be to permit banking organizations subject to the Full LCR to include as a cash inflow an amount equal to a specified percentage (e.g., 30%) of the assets held by the banking organization (if it is an insured depository institution) or by its subsidiary insured depository institutions (if the banking organization is a holding company) that are eligible to be

²² See 12 U.S.C. § 5365(a)(2).

²³ See Enhanced Prudential Standards Proposal *infra* note 27.

²⁴ 75 Fed. Reg. 13,656 (Mar. 22, 2010).

²⁵ See LCR Framework, ¶ 164; see also BCBS, International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version (June 2006), available at <http://www.bis.org/publ/bcbs128.htm>.

pledged as collateral for a discount window advance under section 10B of the Federal Reserve Act (subject to the appropriate haircut applied to such collateral by the Federal Reserve).

B. The Daily Calculation Requirement Is Unnecessary and Unduly Burdensome for Regional Banks Like PNC

The Proposal would require both Full LCR Banks and Modified LCR Banks to calculate the ratio on a daily basis. However, as the Federal Reserve's current and proposed liquidity reporting requirements recognize, the different liquidity profiles of G-SIBs and other banking organizations makes daily monitoring of liquidity at non-G-SIBs less necessary. Specifically, as noted above, we understand that the Federal Reserve requires only G-SIBs—but not other banking organizations—to provide detailed daily liquidity reporting under the Federal Reserve's 4G liquidity reporting program. In addition, the Federal Reserve's proposed liquidity monitoring framework also recognizes that the supervisory need for daily liquidity monitoring differs between regional banks like PNC and G-SIBs.²⁶ Specifically, under the proposed FR 2052 reporting framework only G-SIBs would be subject to a daily complex institution liquidity monitoring report (the FR 2052a). PNC and other regional banks, on the other hand, would be subject to monthly liquidity reporting on the FR 2052b.

We believe that a daily calculation of the ratio is not necessary for firms, like PNC, that are funded predominately by core deposits and that do not rely to a significant extent on potentially volatile, short-term sources of wholesale funding. As discussed in Section II.A. above, PNC's ratio of core deposits to total assets is 67%, well above the 29% average among G-SIBs. PNC's reliance on wholesale funding ratio (16%) and loan-to-deposit ratio (90%) also are very different from the average ratios for the G-SIBs for the same metrics (46% and 61%, respectively). As a result, our liquidity inflows and outflows are more stable and predictable than those of larger and more complex organizations. Our liquidity risks are, thus, easier for management to monitor and manage through traditional means without the need for a daily liquidity coverage ratio calculation. Monthly calculation frequency for PNC (and organizations like it) also would be consistent with the Federal Reserve's proposed rules to implement the enhanced liquidity standards required under section 165 of the Dodd-Frank Act, which would require covered companies to conduct internal liquidity stress tests at least monthly.²⁷

Besides being unnecessary for core funded organizations, like PNC, developing, implementing and adequately testing the extensive systems necessary to calculate the ratio on a daily basis would be expensive and time consuming. PNC is able to manage its daily liquidity with significant precision within our centralized treasury function. The "on-demand" nature of the proposed daily calculation, however, will create a significant new work-set for liquidity managers. Daily calculation would require banks to devote significant efforts toward tracking daily customer activity, for example, in order to appropriately classify the thousands of new lending and deposit exposures that may occur in a given day. Liquidity managers would need to spend considerable time reviewing individual customer activity on a real-time, daily basis and then reconciling and validating the daily LCR position.

²⁶ See *supra* note 20.

²⁷ Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies; Proposed Rule, 77 Fed. Reg. 594 (Jan. 5, 2012) ("Enhanced Prudential Standards Proposal").

Moreover, we are concerned that many organizations would be unable to implement the systems necessary to calculate the ratio on a daily basis by the proposed January 1, 2015, effective date, especially because final rules likely will not be published until 2Q 2014, at the earliest. These difficulties will be particularly acute for organizations that have not been, and would not be, subject to daily liquidity reporting under current or proposed regulatory initiatives. As noted above, PNC is not subject to the Federal Reserve's current daily liquidity reporting requirements, nor is PNC within the scope of the Federal Reserve's proposed daily complex institution liquidity monitoring report. Accordingly, while we maintain robust systems to monitor and forecast our liquidity position, prior to release of the Proposal, we had no reason to expect that the Agencies would seek to require regional banks like PNC to calculate the LCR on daily basis.²⁸ Thus, unlike banking organizations that are subject to the 4G liquidity report or that would be subject to the proposed FR 2052a, regional banks were not on notice that systems capable of supporting a daily calculation might be required.²⁹

For the foregoing reasons, we recommend that, instead of requiring daily calculation, the Agencies harmonize the frequency of calculating the ratio with the reporting frequency the Federal Reserve already has proposed for its liquidity monitoring report. Using those criteria, the requirement to calculate the ratio on a daily basis would apply to G-SIBs, whereas PNC and other regional banking organizations would be subject to a monthly calculation. Applying the daily calculation requirement in this manner would appropriately reflect the differences between regional banking organizations, like PNC, and larger and more complex banking organizations in the context of the LCR.³⁰

If the Agencies nonetheless decide to maintain the daily calculation requirement even for regional banking organizations, we respectfully request that banks that presently are not subject to the Federal Reserve's daily liquidity monitoring report requirements be given additional time to transition to a daily LCR calculation regime. In such circumstances, we believe that banking

²⁸ In this regard, the LCR Framework released in January 2013 appeared to provide for even the largest and most complex firms to calculate the ratio monthly. LCR Framework, ¶ 162.

²⁹ As part of its analysis of the Proposal under the Unfunded Mandates Reform Act of 1995, the OCC estimated that Full LCR Banks it supervises (21 national banks and federal savings associations) would each spend approximately 2,760 hours during the first year the rule is in effect primarily to develop the systems to collect and process the data needed to calculate the LCR. It is unclear from the OCC's estimate whether the agency took the different reporting capabilities of Full LCR Banks it supervises (many of which currently are not subject to a daily liquidity reporting framework) into account. Nonetheless, we believe that the OCC's figure greatly underestimates the burden associated with implementing the daily calculation requirement by many multiples.

³⁰ The Agencies could leverage the supervisory process in situations where heightened monitoring of liquidity resources would be warranted. We believe the simpler liquidity risk profile of PNC would make such monitoring effective. Adopting the monthly calculation approach also would necessitate conforming changes to the proposed notification procedures banking organizations would be required to adhere to if their ratio falls below the level required. As proposed, the remediation requirements are tied to the requirement to calculate the ratio on a daily basis. We believe that, for organizations subject to a monthly calculation, the shortfall notification procedures should apply if the organization's monthly report indicates the bank fell below the required level. Similarly, the requirements for a mandatory corrective action plan should apply if the organization remains below the required level for two consecutive months (as indicated in the monthly report), unless the relevant Agency determined that a corrective action plan was needed sooner.

organizations that are not currently subject to a daily liquidity reporting requirement should be given until 2017, at a minimum, to transition to a daily calculation. We note that the BCBS has itself recognized that a delay of the daily reporting requirement until 2017 may be appropriate even for those complex internationally active banks intended to be covered by the LCR Framework.³¹

C. Modified LCR's 21-Day Stress Period Does Not Appropriately Align with the Calendar Month Cycle of Bank Customer Activity

PNC supports the use of cumulative net cash outflows over the stress period, rather than the “worst-day” net cash outflow approach included in the Full LCR.³² Allowing the use of cumulative outflows over the stress period is particularly appropriate for regional banks like PNC because our funding profile is simpler and less volatile than larger and more complex organizations. Thus, we do not present the same concerns about potential intra-month maturity mismatches that appear to have been a motivating factor for the proposed peak outflow approach under the Full LCR.³³

While we support the cumulative net outflow approach in the Modified LCR, the Modified LCR's 21-day stress period makes calculating and managing the ratio more challenging because most of our customer activity follows a calendar-month cycle. For example, customer loan payments to PNC, and PNC's interest payments to deposit customers (outflows), typically occur once per calendar month, rather than once every 21 or 30 days. Given that customer activity is rooted in a calendar-month cycle, we also manage maturities and refinancing with a monthly view in mind. For example, we can predict the time of the month when large volumes of customer payments will be received and can time debt maturities based on that monthly time frame. The 21-day forward-looking stress period required under the Modified LCR would consistently omit key recurring payment activity that occurs on the calendar-month cycle and encourage a view of liquidity and cash flows that is inconsistent with our business model or the periodicity of our cash inflows and outflows.

Accordingly, we respectfully ask the Agencies to modify the proposed 21-day stress period under the Modified LCR to instead provide for a calendar-month stress period.³⁴ Under this approach the Modified LCR would be calculated using the Federal Reserve's proposed outflow and inflow assumptions (based on 70% of the proposed outflow and inflow rates under the Full LCR) over the course of a calendar-month projection period. Modifying the projection period in this way would better align the Modified LCR with the way in which we manage liquidity flows, as well as financial and external regulatory reporting cycles. We believe retaining the Modified LCR's proposed outflow and inflow rates after modifying the projection period would appropriately scale the assumptions under the Full LCR to regional banking organizations, like PNC, that

³¹ See BCBS, Liquidity coverage ratio disclosure standards (January 2014), ¶ 13, available at <http://www.bis.org/publ/bcbs272.pdf>.

³² See Joint Trade Association Comment Letter, Section II.A.1.

³³ Proposal, at 71,833.

³⁴ We also believe that the Full LCR should follow a calendar-month projection period, rather than the proposed 30-calendar day approach.

present less liquidity risk.³⁵ Adopting the calendar-month approach would also decrease the complexity of the LCR calculation for regional banking organizations.

D. Public Sector Deposits Required to Be Collateralized with HQLA Should Not Be Treated Like Short-Term Repurchase Agreements

Deposits placed by states and local governments generally must be collateralized under state law by high-quality collateral,³⁶ such as Treasury securities, GSE obligations, or FHLB letters of credit (“LCs”).³⁷ These types of deposits are generally referred to as “preferred deposits.”³⁸ Preferred deposits are generally placed with banks in connection with banking services states or local governments seek to obtain from banks (e.g., treasury management services). States and municipalities generally do not pay directly for these services but instead receive earnings credits for the deposits placed with the bank.

The Proposal would have significantly adverse effects on the market for preferred deposits by subjecting these generally stable deposit relationships to (i) provisions of the Proposal designed to address potential manipulation of the LCR through short-term securities financing transactions; and (ii) outflow rates that are not consistent with stress experience. As a result, we are concerned that banking organizations likely would have to limit the amount of preferred deposits they accept, reduce the interest paid on preferred deposits, or eliminate earnings credits extended to state and municipal depositors. To avoid these adverse consequences for state and municipal customers, we urge the Agencies to modify the treatment of these deposits in the final rule in the following ways.

1. Adjusted HQLA Cap

The Proposal requires that the caps on Level 2 liquid assets (i.e., 40% of total HQLA for Level 2 and 15% for Level 2B) be calculated both before and after giving effect to an assumed unwind of any HQLA-for-HQLA transactions (e.g., repurchase agreements or collateral swap

³⁵ Scaling the outflow assumptions applicable to regional banks, like PNC, would be particularly appropriate considering that, as noted above, regional banking organizations predominantly operate through depository institution subsidiaries that have access to ordinary course liquidity sources, such as advances from the Federal Reserve’s discount window under section 10B of the Federal Reserve Act and FHLB advances. As these resources would make a liquidity stress event easier for regional banks like PNC to manage without the need for extraordinary liquidity support, lower inflow and outflow rates are both appropriate and possible without unduly increasing the risk of potential liquidity-induced failures absent extraordinary assistance.

³⁶ See, e.g., Ohio Rev. Code §§ 135.18, 135.181, and 135.37. Under Ohio law, a bank cannot accept deposits of public moneys from a subdivision or county, unless the bank pledges collateral for the repayment of all public moneys to be deposited in the institution.

³⁷ See, e.g., Ohio Rev. Code § 135.18 (specifying the types of securities eligible to be pledged as collateral under that requirement, including, among others, GSE obligations, Treasury securities, and U.S. government agency securities); see also 72 P.S. § 3836-4 (describing the types of assets that may be used to secure public deposits, including FHLB letters of credit).

³⁸ See 12 U.S.C. § 1813(m)(4).

transactions).³⁹ The lower of the two HQLA amounts would be used to calculate the ratio. The Agencies explain in the Proposal that the adjusted excess HQLA requirement is intended to prevent a banking organization from manipulating its HQLA portfolio by engaging in transactions that mature within 30 days, such as repurchase or reverse repurchase transactions, because the HQLA amount, including the caps and haircuts, would be calculated both before and after unwinding those transactions.⁴⁰

The Proposal, however, would treat preferred deposits collateralized with GSE obligations or other types of HQLA in the same manner as repurchase agreements for purposes of the adjusted excess HQLA calculation.⁴¹ As discussed in both the Joint Trade Association Comment Letter and the Regional Bank Comment Letter,⁴² applying the proposed unwind requirement to preferred deposits could well result in situations where the transactions result in a negative HQLA amount. Moreover, under the Proposal, preferred deposits would be subject to both an outflow assumption (generally 15%, when secured by GSE securities) and the adjusted excess HQLA provision that would require banking organizations to assume that the transaction is unwound.

While we support the Agencies' goal of preventing banking organizations from manipulating their stock of HQLA, preferred deposits simply do not raise those concerns. Preferred deposits generally are established through a request for proposal process and represent part of long-term banking relationships with state and municipal governments. Moreover, these deposits are generally placed with PNC in connection with other services the public sector customer seeks to obtain from us, e.g., payments and receivables treasury management services, and are not susceptible to the type of short-term gaming the Agencies seek to address.

Accordingly, preferred deposits do not raise the concerns about manipulation the Agencies seek to address with the requirement to calculate the adjusted excess HQLA amount. For these reasons, we request that the Agencies clearly exclude preferred deposits from the requirement to unwind HQLA-for-HQLA transactions in the final rule. We note that the Proposal's language subjecting preferred deposits backed by HQLA to the unwind requirement may have been unintended. For example, in describing the reasons for, and application of, the adjusted HQLA cap, both the LCR Framework and the Proposal focus on repurchase, reverse repurchase, and securities financing transactions—not preferred deposits.⁴³ After excluding them from the

³⁹ The measures are referred to in the Proposal as the “unadjusted excess HQLA amount” and the “adjusted excess HQLA amount,” respectively.

⁴⁰ Proposal, at 71,831.

⁴¹ The Proposal defines the “adjusted level 2A liquid asset amount” as the amount equal to 85 percent of the fair GAAP value of all level 2A liquid assets that would be held by the banking organization upon the unwind of, among other things, any “secured funding transaction.” See § __.21(f)(2). The term “secured funding transaction” is defined to include any transaction that gives rise to a cash obligation of the banking organization to a counterparty that is secured under applicable law by a lien on specifically designated assets owned by the banking organization that gives the counterparty, as holder of the lien, priority over the assets. See § __.3.

⁴² See Joint Trade Association Comment Letter, Section II.A.5 and Annex B; and Regional Bank Comment Letter, Part III.A and App. 2.

⁴³ See Proposal, at 71,831; LCR Framework, ¶ 48.

unwind requirement, preferred deposits secured with GSE obligations, for example, would continue to be subject to a 15% outflow assumption. As discussed in the following section, we believe the Agencies should clarify how the rules apply to preferred deposits secured by FHLB LCs and ensure that the outflow rates for these deposits reflect the actual historical outflow of preferred deposits, even in times of stress.

2. Outflow Assumptions for Preferred Deposits Backed by FHLB LCs

Many state laws allow deposits of public funds to be secured by FHLB LCs.⁴⁴ Because FHLB LCs do not meet the definition of HQLA, preferred deposits backed by FHLB LCs do not appear to be subject to the unwind requirements discussed above. However, it is unclear from the Proposal what outflow rate would apply to preferred deposits secured with an FHLB LC.

We believe the same 15% outflow rate should apply to a preferred deposit backed by an FHLB LC as would apply to a preferred deposit backed by GSE obligations. Both types of deposits are backed by obligations of a GSE. Moreover, historical data shows that, even during times of economic stress, public deposits remain more stable than the proposed outflow assumptions would require banking organizations to assume. The aggregate peak 90-day outflow rate of public sector deposits observed for a group of institutions that experienced significant stress during the recent financial crisis (including one institution that failed and two others that were acquired due to the stress they were experiencing) was approximately 8.8%.⁴⁵ Even looking just at the three institutions within the group that either failed or were acquired as a result of stress,⁴⁶ the aggregate peak 90-day outflow rate of public sector deposits during the crisis was approximately 15.9%.

<u>Group of Institutions</u>	Aggregate Peak 90-day Outflow Rate
Institutions that experienced significant stress (including institutions that failed or were acquired due to stress)	8.8%
Institutions that failed or were acquired due to stress	15.9%

⁴⁴ See, e.g., Fla. Stat. §280.13, 15 Il. Comp. Stat. 520/11, Md. Code § 6-202, N.J. Stat. Ann. § 17:9-41, 72 P.S. § 3836-4.

⁴⁵ This group includes (i) institutions that failed or were acquired due to stress during the financial crisis (i.e., National City Bank, Washington Mutual Bank, and Wachovia Bank); and (ii) a group of non-systemically important institutions that lost 90% or more of their market cap in the period between December 31, 2007, and December 31, 2009 (i.e., Fifth Third Bank, The Huntington National Bank, Regions Bank, and SunTrust Bank).

⁴⁶ This group includes only National City Bank, Washington Mutual Bank, and Wachovia Bank.

⁴⁷ Source: FDIC - Statistics on Depository Institutions (data between December 31, 2007, and September 30, 2009).

While the historical data does not break out preferred deposits by collateral type, we have no reason to believe that there would be a material difference between the outflow rates for deposits collateralized by GSE obligations or an FHLB LC, as both represent a claim guaranteed by a GSE.

For these reasons, we respectfully request that the Agencies provide in the final rule that preferred deposits backed by FHLB LCs receive the same 15% outflow assumption the Agencies propose to apply to preferred deposits backed by GSE obligations and other Level 2A liquid assets. We believe that harmonizing the outflow assumptions for preferred deposits—regardless of whether they are backed by GSE obligations or FHLB LCs—would more accurately reflect the observed behavior of public sector depositors during times of severe economic stress. Should the Agencies determine not to do so, we ask that the Agencies, at the very least, confirm that FHLB LC-backed preferred deposits that satisfy the operational deposit criteria receive an outflow rate of no higher than 25%.

E. Requirements for Recognizing Certain Deposits as “Operational Deposits”

We agree with the objectives regarding operational deposits the Agencies discuss in the Proposal.⁴⁸ The Proposal, however, adds several specific criteria that a deposit would have to satisfy in order to be treated as an “operational deposit” that are ambiguous, are inconsistent with how operational deposits function, are in several instances not required under the LCR Framework, and would not further the Proposal’s goals. In addition, the requirements for recognizing certain deposits in connection with cash management, clearing, or custody services as “operational deposits” are unnecessarily cumbersome and should be streamlined. We are concerned the Proposal’s treatment of operational deposits may unnecessarily narrow the scope of what constitutes an operational deposit in a way that runs the risk of causing the vast majority of operational deposits to not qualify under the Proposal. The ambiguity of certain of the proposed requirements also could lead to inconsistent application of the rule’s operational deposit methodology. For these reasons, we believe the Agencies should revisit the proposed operational deposit framework and eliminate those criteria that are unnecessary or fundamentally at odds with how operational deposits function, and otherwise clarify certain other criteria.

We highlight our most significant concerns below:

1. Termination Provisions

In order to qualify as an operational deposit under the Proposal, the deposit must:

“be held pursuant to a legally binding written agreement, the termination of which is subject to a minimum 30 calendar-day notice period or significant termination costs are

⁴⁸ Operational deposits are expected to have a lower impact on an institution’s liquidity during times of liquidity stress because the likelihood of significant withdrawals within the stress period would be reduced due to legal or operational limitations. The Proposal provides the example of a company that relies on an institution for payroll processing services. Such a customer would not be likely to move that banking relationship to another institution during a liquidity stress because the customer’s need for stability in providing payroll are unaffected by stresses in the broader financial markets. Proposal, at 71,841.

*borne by the customer providing the deposit if a majority of the deposit balance is withdrawn from the operational deposit prior to the end of a 30 calendar-day notice period.*⁴⁹

Operational deposits are, by definition, held for the purposes of supporting the critical business functions of a company (including payroll and other payments and collections). As a result, these deposits are held in liquid accounts that typically do not require any notice for withdrawal of deposits. However, customers do enter into legally binding written agreements with the bank relating to the operational services associated with the deposit and these agreements include service termination provisions. Additionally, there are substantial costs for a company to move an operational relationship to another institution in addition to any termination fee that may be imposed by this agreement. These costs include, but are not limited to, system testing, conversion and integration costs, re-establishing data transmissions, and a multitude of other operational expenses incurred by a customer in connection with the transition of operational services. For customers that use cash management services to operate their business, transitioning to a new service provider could take significantly longer than 30 days. We, therefore, recommend that this requirement focus on the termination provision of the operational services agreement and recognize that a customer's switching costs comprise more than just the cost associated with terminating the agreement, but also those systems and other operational costs associated with transitioning the operational services to another provider.

2. Designated Operational Account

The Proposal would require that a “*deposit must be held in an account designated as an operational account*” in order for the deposit to be eligible as an operational deposit. Customers efficiently manage and fund their daily operations and take into consideration all liquid funds available to them without penalty when making decisions about funding operations. A customer must have specific operational services in order to facilitate payments and collections, however, the funds that are utilized as part of those operations may not necessarily originate from or remain in a transactional account. Automated and real time funds transfers, including sweep services, standing transfer orders, zero balance accounts, etc., allow customers to easily move liquid funds across their entire banking relationship when the funds are required for operational use, without necessarily leaving them in the account that has transactional capabilities. For these reasons, we believe the agencies should revise this criterion to read as follows:

“The deposit must be held in a liquid account that can be accessed by a customer immediately and without penalty.”

3. Average Balance Volatility

A further requirement in order for a deposit to qualify as an operational deposit under the Proposal is that “there must not be significant volatility in the average balance of the deposit.”⁵⁰ However, the balance of an operational deposit normally fluctuates as funds are used to meet operational needs of the depositor. We are concerned that the “significant volatility” language

⁴⁹ Section __.4(b)(1) of the Proposal.

⁵⁰ Section __.4(b)(2) of the Proposal.

could disqualify deposits based on normal variations in deposit balances due to the nature of the operational services provided, rather than due to other factors, such as the customer's perception of the financial condition of the banking organization. Ordinary course changes in balances needed for the related operational services should not preclude treatment as operational deposits. Moreover, we note that any concern that amounts not related to the underlying operational services might inappropriately receive the lower operational deposit outflow rate is already addressed by the requirement to exclude any "excess amount."⁵¹ Therefore, the "significant volatility" requirement is unnecessary and we respectfully request that the Agencies remove this criterion in the final rule.

4. No Incentive to Maintain Excess

The Proposal also would require that the account holding the operational deposit cannot be designed to create an economic incentive for the customer to maintain excess funds in the account.⁵² Many operational services customers, however, evaluate anticipated economic benefits in advance of determining where to establish banking relationships and the implementation of operational services and receive earnings credit reductions ("ECR") for their operational service-related deposits. In addition, any concern that operational deposit balances not related to the underlying operational services might be included is already addressed by the requirement that banks exclude any "excess amount" from the amount treated as operational deposits.⁵³ Accordingly, we ask the Agencies to remove this criterion in the final rule.

5. Disqualification of Excess Amounts

Like the LCR Framework,⁵⁴ the Proposal would require a bank to exclude "any excess amount" from the operational deposit amount.⁵⁵ In this regard, the bank must be able to demonstrate that the deposit is "empirically linked" to operational services and that the bank has a methodology for identifying any excess amount that must be excluded.⁵⁶ We believe these proposed requirements are reasonable provided that institutions do not have to demonstrate these requirements on an account-by-account basis.

Because the normal day-to-day flow of operational activities across customer relationships results in variability, institutions like PNC that provide operational services evaluate deposits related to these services on an aggregate or deposit-type basis, rather than on an account-by-account basis. In light of this current industry practice, we respectfully ask that the Agencies clarify in the final rule that an institution is not required to demonstrate its empirical assessment of excess operational deposits on an account-by-account basis. Absent further clarification from the Agencies in this regard, we are concerned that institutions would be subject to the operational burden of assessing operational deposits in an unnecessarily granular manner,

⁵¹ Section __.4(b)(6) of the Proposal.

⁵² Section __.4(b)(5) of the Proposal.

⁵³ Section __.4(b)(6) of the Proposal.

⁵⁴ LCR Framework, ¶¶ 96 and 97.

⁵⁵ Section __.4(b)(6) of the Proposal.

⁵⁶ Section __.4(b)(6) of the Proposal.

which, in turn, also would impose an unnecessary burden for supervisors tasked with reviewing an institution's methodology for assessing operational deposits.

F. Agencies Should Clarify the Definition of "Special Purpose Entity" to Exclude Operating Companies and Revise Outflow Amounts for Credit and Liquidity Facilities Provided to Bank Customer Securitization Credit Facilities

Under the Proposal, banking organizations would be required to apply a 100% outflow rate for the undrawn amount of all committed credit and liquidity facilities extended to special purpose entities ("SPEs") that could be drawn within the stress period.⁵⁷ The Agencies indicate that this treatment is appropriate considering that SPEs are sensitive to emergency cash and backstop needs in a short-term stress environment, such as those experienced by SIVs during the recent financial crisis. We are concerned that the Agencies' proposed definition of SPE is overly broad and could capture a wider range of entities than the Agencies intended.

Specifically, the proposed SPE definition would appear to capture certain types of operating companies that are established for, and operate to achieve, a specific purpose. Such entities could include, for example, individual limited liability companies that are formed to develop, operate, or manage specific real estate assets, such as an apartment building, hotel or office complex. We do not believe the Agencies intended to cover operating companies with the proposed definition.⁵⁸ Accordingly, we respectfully request that the Agencies modify the definition of SPE in the final rule to clarify that operating companies are not the type of companies intended to be captured with the SPE definition.

We also are concerned that the Proposal does not appropriately recognize that transactions where, for example, an SPE acts as the borrower in a securitized credit facility established to finance the receivables originated by a commercial company sponsoring the SPE are fundamentally different from the types of transactions involving SPEs that might warrant a 100% outflow rate. For example, bank customers often establish securitization credit facilities as substitutes for, or complements to, traditional secured and unsecured revolving credit facilities. In these securitization facilities, the bank customer accesses financing by selling financial assets (e.g., receivables generated in the normal course of the customer's business) to an SPE that it sponsors.⁵⁹ Draws on a bank customer securitization facility are strictly limited by a borrowing base of eligible financial assets (e.g., receivables), which are generated through the bank customer's business. Bank customers value securitization credit facilities because these facilities allow them to diversify their sources of funding by borrowing on the credit quality of the receivables their business generate. Often, securitization credit facilities also offer the most cost effective funding option available.

In times of economic stress, reduced sales by the customer naturally would result in fewer receivables to support funding under the facility. In other words, the borrowing base would

⁵⁷ Section __.32(e)(vi) of the Proposal.

⁵⁸ For example, we note that for FR Y-14Q reporting purposes, the Federal Reserve has indicated that SPEs are generally not operating companies and ordinarily can make no substantive decisions.

⁵⁹ This process is beneficial from a safety and soundness perspective as the SPE structure isolates the collateral from the bank customer's bankruptcy and credit risk.

adjust to reflect decreased receivables. As a result, the customer's ability to draw on the facility and bank outflows related to the facility would typically be constrained during times of economic stress, rather than increasing. The 100% outflow rate the Agencies propose to apply for undrawn commitments to all SPEs very likely would require banks lending to customers' securitization credit facilities to limit the availability or increase the pricing of such funding. As a group of end-users of bank customer securitization credit facilities noted, this could well limit the end-users' ability to provide ordinary course of business financing to their customers, thus hampering the growth of their businesses.⁶⁰

We believe that the outflow amount for a bank customer securitization credit facility should match the outflow amount that would apply to a credit facility extended directly to the bank customer. Accordingly, we respectfully request that the Agencies revisit the proposed treatment of SPEs established in connection with bank customer securitization facilities in the final rule and adopt the modifications to the Proposal recommended by the Structured Finance Industry Group ("SFIG") and the Securities Industry & Financial Markets Association ("SIFMA") in their comment letter (the "SFIG/SIFMA Comment Letter").⁶¹ The "look through" approach recommended by SFIG and SIFMA, and supported by the End-User Comment Letter, would appropriately harmonize the outflow treatment that applies to bank customer securitization facilities with the outflow amounts for credit commitments extended to the underlying bank customer given the functional similarity of these two transactions. As explained in the SFIG/SIFMA Comment Letter, this modification would apply only to facilities that qualify as a "bank customer securitization facility," as defined in that letter, and this term has been defined narrowly to exclude other types of SPE-related facilities that might warrant a 100% outflow amount.

G. Requirements for Determining Maturity

The Proposal requires a banking organization to assume that it would not exercise an option that would allow the organization to extend the maturity of any obligation it has issued.⁶² However, it is unclear from the Proposal whether the Agencies also intend to require a banking organization to assume that call options that allow the organization to close out a wholesale funding instrument, such as long-term debt, in advance of the contractual maturity date are exercised at their earliest possible date.

Requiring a banking organization to assume that it exercises these types of options (which are in the organization's control) is counterintuitive, as it would imply that the banking organization must disadvantage itself in a stress scenario by, for example, using its discretion to exercise a 30-day call option embedded in certain of its debt instruments and thereby accelerate its outflows during the stress period. Debt instruments with embedded call options, e.g., a 30-day call option, are purchased by sophisticated institutional investors and provide the issuing banking organization with an important degree of funding flexibility. There is no market expectation that a banking organization would exercise such a call option on its long-term debt

⁶⁰ See Letter to the Agencies from Arch Chemicals, Inc., Arch Coal, Inc., Arkansas Best Corp, et al. (Jan. 31, 2014) ("End-User Comment Letter").

⁶¹ See generally Letter to the Agencies from SFIG and SIFMA (Jan. 31, 2014), Section I.A.

⁶² Section __.31(a)(ii) of the Proposal.

in a stress environment. We, therefore, respectfully ask that the Agencies clarify in the final rule, or the preamble thereto, that a banking organization is not required to assume that it would exercise call options embedded in wholesale funding instruments issued by the banking organization that would accelerate maturity of the instrument.

We have similar concerns with respect to certain types of credit commitments that provide that the customer must provide the bank with prior notice (e.g., 35 days' notice) before the bank funds the commitment.⁶³ In other words, the bank is under no legal obligation to fund the commitment until the expiration of the prior notice period agreed-upon with the bank customer. Section 31 of the Proposal, however, could be read to suggest that the bank must assume it funds the obligation before the expiration of the notice period, i.e., that the bank funds the commitment before it is legally obligated to do so.

We do not believe that banks should be required to disregard a mandatory contractual notice period and, furthermore, do not believe this to be the intended application of section 31. There is no indication that, during the recent financial crisis, bank customers regularly sought waivers of contractual notice periods or that banks routinely waived such provisions. Moreover, it would seem unlikely that during a stress period, such as that required under the Proposal, a bank would exercise its discretion to waive or shorten a notice period. For these reasons, we respectfully request that the Agencies clarify in the final rule that a bank is not required to disregard customer contractual notice periods and that, therefore, credit commitments that provide for a mandatory prior notice of more than 30 days will not be subject to an outflow assumption.

Further, in certain transactions, a bank may have the option of deferring the funding of obligations under commitments for more than 30 days after a request for funding is received from its customer. If banks can eliminate or mitigate potential liquidity demands by negotiating the right to defer funding for more than 30 days, the Agencies should not eliminate an incentive for banks to negotiate for these provisions, which allow banks to prudently manage liquidity requirements in a stress period, by treating the commitment as still creating an outflow during the required stress period. We respectfully request that the Agencies clarify that a bank may assume that a bank option to extend its funding obligations under commitments beyond a 30 calendar-day stress period would be exercised.

H. Proposal Should Be Modified to Reflect the Proven Liquidity Value of GSE Obligations and the Federal Home Loan Bank System

We are concerned that the Proposal does not take the proven liquidity value of two unique and important aspects of the U.S. financial system—GSE obligations⁶⁴ and the FHLB System—appropriately into account. GSE obligations trade in deep and well-developed markets and, we

⁶³ Notice periods, for example, help to ensure that there is sufficient time to complete actions (e.g., valuations) required to fund the commitment. A bank is therefore unlikely to waive, or even shorten, a mandatory notice period, regardless of whether the bank is facing stress.

⁶⁴ GSE obligations refers to obligations issued or guaranteed as to principal and interest by the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”), including residential mortgage-backed securities guaranteed by Fannie Mae or Freddie Mac (“GSE RMBS”).

believe, exhibit liquidity characteristics that merit greater recognition of these assets under the LCR. For example, trading volume and other data collected by TCH indicates that GSE RMBS are consistently readily-convertible into cash.⁶⁵ Based on annual daily trading volume data since 2004, the market for GSE RMBS is second only to the market for U.S. Treasury obligations.⁶⁶ Apart from U.S. Treasury obligations and Japanese Government Bonds, the market for GSE RMBS is the next largest in the world in terms of outstanding notional values--with over \$4 trillion in outstanding GSE RMBS and with an average daily trading volume in 2013 of almost \$230 billion.

While the Agencies acknowledge that securities issued and guaranteed by the GSEs consistently trade in very large volumes and generally have been highly liquid, including during times of stress,⁶⁷ the Proposal would treat these assets as Level 2A liquid assets subject to the 40% cap on total Level 2 assets and a 15% haircut. We believe that this treatment does not adequately reflect the proven liquidity value and observed price behaviors of GSE obligations, even in times of severe stress. Treating GSE obligations as Level 2A assets also is inconsistent with the enhanced liquidity standards the Federal Reserve proposed under section 165 of the Dodd-Frank Act, which would classify GSE obligations as fully liquid.⁶⁸

For these reasons, we support the recommendations of the Joint Trade Association Comment Letter and the Regional Bank Comment Letter that the Agencies treat GSE obligations as Level 1 liquid assets in the final rule to properly reflect their well-established liquidity value.⁶⁹ We believe this is particularly appropriate in light of the fact that Fannie Mae and Freddie Mac currently receive capital support from the U.S. Treasury under the terms of the Preferred Stock Purchase Agreements (“PSPAs”) while operating under the conservatorship of the Federal Housing Finance Agency. We believe treating GSE obligations as Level 1 liquid assets is permissible under the LCR Framework⁷⁰ and is fully consistent with the framework given that GSE obligations are effectively guaranteed by the full faith and credit of the U.S. government as a result of the PSPAs.

If the Agencies nonetheless decide to continue to treat GSE obligations as Level 2A liquid assets, we recommend modifying the structure of the 40% cap on Level 2 liquid assets consistent with the approach recommended in the Joint Trade Association and Regional Bank Comment Letters. We believe that a modified cap on GSE obligations would address the unrealistic outcome under the Proposal where any amount of GSE obligations over the 40% cap would receive zero liquidity value. The modified cap proposed in the Joint Trade Association and Regional Bank Comment Letters would apply an increasing haircut to GSE obligations as the percentage of such

⁶⁵ See TCH, The Basel III Liquidity Framework: Impacts and Recommendations (Nov. 2, 2011), at 9-12.

⁶⁶ Id.; see also Joint Trade Association Comment Letter, Section IV.A.1.

⁶⁷ Proposal, at 71,827.

⁶⁸ See supra note 24.

⁶⁹ See Joint Trade Association Comment Letter, Section IV.A.1; and Regional Bank Comment Letter, Part III.C.

⁷⁰ In light of the PSPAs, we believe GSE obligations can be treated as sovereign obligations under paragraph 58 of the Basel II Standardized Approach (even though Fannie Mae and Freddie Mac are not sovereign entities) and treated as Level 1 liquid assets under paragraph 50(d) of the LCR Framework.

obligations in total HQLA increases, and thereby limit the amount of GSE obligations a banking organization could include as HQLA to no more than 80% of its total HQLA. We believe this approach would more appropriately balance the actual liquidity value of GSE obligations with potential concerns regarding the over-reliance on such obligations for liquidity management.

Also, we are concerned that the Proposal does not recognize that depository institutions have the ability, even in times of stress, to access liquidity from the FHLBs through secured advances. A depository institution's unused capacity to obtain FHLB advances is not recognized as HQLA or as a potential cash inflow to offset cash outflows in the LCR's denominator. The FHLBs are a unique aspect of the U.S. financial system, and proved to be an important and reliable source of liquidity for depository institutions during the financial crisis.⁷¹ For these reasons, we believe the Agencies should recognize the FHLBs as a proven source of liquidity by permitting a banking organization to count a portion of the unused FHLB borrowing capacity of its subsidiary depository institutions as a cash inflow.

I. Certain State and Local Government Obligations Warrant Inclusion as Level 2A Liquid Assets

Under the Proposal, a banking organization would receive no HQLA credit for any state and local government obligations. The LCR Framework, however, would allow a banking organization to receive Level 2A credit (subject to a 15% haircut and the 40% cap on all Level 2 assets) for state or local government obligations if the obligations qualify for a 20% risk weighting under the standardized regulatory capital framework and meet certain other criteria.⁷² In the Proposal, the Agencies indicated that the decision to completely exclude state and local government obligations from the definition of HQLA was motivated by concerns that state and local government obligations are "not liquid and readily-marketable in U.S. markets and thus do not exhibit the liquidity characteristics necessary to be included in HQLA." We are concerned that if state and local government obligations are prohibited from inclusion in HQLA, then banking organizations will face strong disincentives to acquiring even the highest quality and most liquid state and local government obligations, potentially shrinking the market for these obligations and increasing the cost of credit for states and local governments.

While we concur that some state and local government obligations may not have the trading volumes or credit quality to support inclusion in HQLA, we believe that there are issuances of large and highly-rated states and local governments that are of sufficient size to warrant inclusion as Level 2A liquid assets. Therefore, instead of entirely foreclosing these assets from being eligible as HQLA, we believe that the Agencies should allow banks to include certain state and local government obligations as Level 2A liquid assets consistent with the LCR Framework. One option would be to follow a similar approach to that taken by the European Bank Authority ("EBA"). The EBA recently issued a report recommending that bonds issued by local European governments should be treated as HQLA if the obligations have (i) an external credit rating of "ECAI 2" or above, (ii) a minimum issue size of € 250 million, and (iii) a maximum time to maturity of 10 years.⁷³

⁷¹ See supra note 65, at 14-15.

⁷² LCR Framework, ¶ 52.

⁷³ EBA, Report on appropriate uniform definitions of extremely high quality liquid assets (extremely HQLA) and high quality liquid assets (HQLA) and on operational requirements for liquid assets under Article

J. Conditions on U.S. Agency and GSE Obligations to Be Considered HQLA Are Unnecessary and Should be Removed

Eligible Level 1 HQLA includes both Treasury obligations and other obligations issued, or unconditionally guaranteed as to timely payment of principal and interest, by other U.S. government agencies (such as the Government National Mortgage Association) that are backed by the full faith and credit of the U.S. government.⁷⁴ However, Agency securities (unlike Treasury securities) can be included in HQLA only if the banking organization can demonstrate that the securities are “liquid and readily-marketable,” meaning that they are traded in an active secondary market with (i) more than two committed market makers; (ii) a large number of non-market maker participants on the buying and selling side; (iii) timely and observable market prices; and (iv) a high trading volume.⁷⁵ GSE obligations also can be included in the stock of HQLA only if the banking organization can demonstrate that these assets meet the conditions to be deemed “liquid and readily-marketable.”

We believe the requirement for banking organizations to demonstrate that Agency and GSE obligations are “liquid and readily-marketable” is unnecessary because these obligations clearly meet these requirements. For example, Agency obligations—like Treasury securities—are backed by the full faith and credit of the United States, and we believe all obligations backed by the full faith and credit of the United States are liquid and readily-marketable. In addition, the data included in the Joint Trade Association Comment Letter clearly demonstrates that GSE obligations also are liquid and readily-marketable. Accordingly, we recommend that the Agencies revise the Proposal to eliminate the requirement that banking organizations demonstrate that Agency and GSE obligations are “liquid and readily-marketable,” as this requirement is unnecessary.

K. Outflow Amount for Securities where the Banking Organization is the Primary Market Maker in Its Own Securities

The Proposal would require a banking organization to recognize an outflow amount associated with its own debt securities if the banking organization is the “primary market-maker” for the securities.⁷⁶ While we recognize that, during times of stress, a banking organization acting as the primary market-maker in its own debt securities may be called upon to provide liquidity and repurchase its debt securities, we support the concerns raised in the Joint Trade Association Comment Letter that the proposed outflow rates in these circumstances are too high. The actual volume of any repurchases made by a banking organization may be lower than the proposed outflow rates because investors may not be willing to have the banking organization repurchase the debt securities during a stress scenario at a price which would result in the investor recognizing a significant loss. We, therefore, believe that the Agencies should adopt the recommendation proposed in the Joint Trade Association Comment Letter which provide

509(3) and (5) CRR (Dec. 20, 2013), available at <http://www.eba.europa.eu/-/eba-publishes-reports-on-liquidity>.

⁷⁴ See generally § __.20(a) of the Proposal.

⁷⁵ Section __.20(a)(4) of the Proposal.

⁷⁶ Section __.32(i) of the Proposal.

additional flexibility in determining outflow rates rather than mandating rates that are unnecessarily high.⁷⁷

L. Proposed Definition of “Regulated Financial Company” Poses Certain Operational Challenges

Under the proposal, securities and other obligations issued by a “regulated financial company” or another financial sector entity would be excluded from HQLA entirely. Similarly, funding provided by a “regulated financial company” generally is subject to the highest outflow assumptions under the Proposal. While we support the Agencies’ efforts to address financial sector interconnection in the Proposal, the definition of “regulated financial company” is overly broad and problematic. Specifically, the second element of that definition would include any company that must be included in the organizational chart of a banking organization subject to the Proposal as reported on the Federal Reserve’s Form FR Y-6 and reflected on the National Information Center website.

Because of the breadth of investments that must be reported on the FR Y-6, this prong of the definition is overly broad and operationally burdensome without providing meaningful benefit. The FR Y-6 is intended to annually provide the Federal Reserve with data to allow supervisory staff to monitor the activities of holding companies and to ensure that their activities are conducted in a safe and sound manner. Accordingly, the FR Y-6 is an expansive form that is meant to capture a substantial range of activities and investments of depository institution holding companies. For example, the FR Y-6 requires a depository institution holding company to include a company on its FR Y-6 organizational chart even if it owns only 5% of a class of the company’s voting securities. A depository institution holding company must also include in its FR Y-6 merchant banking investments that are reportable on the Federal Reserve’s Form FR Y-10.

The scope of the FR Y-6 means that companies would be treated as “regulated financial companies” even where a banking organization’s investment may be significantly below the threshold at which the company would be consolidated for financial reporting purposes or even considered to be “controlled” by the banking organization for purposes of the Bank Holding Company Act. A company in which a banking organization has a minority and possibly noncontrolling interest would not necessarily have the kind of “links” with the banking organization that would be “sufficiently significant” to warrant treatment of such company as a regulated financial company. Moreover, merchant banking investments of banking organizations that are financial holding companies engage in commercial activities and the banking organization is prohibited from routinely managing or operating the company (except for a limited period of time in exceptional circumstances) and must divest the investment within specified periods of time. Thus, we believe it would be inappropriate to characterize these portfolio companies as a regulated financial company. For these reasons, we respectfully recommend that the FR Y-6 prong of the “regulated financial company” definition be deleted from the final rule.

⁷⁷ See Joint Trade Association Comment Letter, Section III.D.

III. Conclusion

Thank you for the opportunity to comment on the Proposal. We would be pleased to discuss our comments further with representatives of the Federal Reserve, OCC, and FDIC at your convenience. In addition, if you have any questions regarding this letter or recommendations made herein, please do not hesitate to contact me at 212-527-3003 or bill.parsley@pnc.com, or Kieran J. Fallon, Senior Deputy General Counsel, at 202-973-6256 or kieran.fallon@pnc.com.

Sincerely,



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